Social Security: Facing the facts and facing the future

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Why reform is needed

Former New York Senator Daniel Patrick Moynihan once observed, “you are entitled to your own opinion, but you are not entitled to your own facts.” As the Democratic co-chair of President Bush’s bipartisan Social Security Commission (on which I also served), Moynihan challenged our Commission to start with the facts before we proceeded to any conclusions. Good advice. And the facts about Social Security’s future are not hard to find. Reputable organizations – such as the bipartisan Congressional Budget Office and the Social Security Trustees– have regularly issued reports that point to a fiscal crisis in Social Security as the babyboom generation begins to retire.

Recently, another respected government agency – the Government Accountability Office (GAO) – released a report with similar findings. According to GAO, given the cost pressures created by the babyboom generation and other factors, annual payroll tax revenues will not fully cover benefits beyond the year 2018. And, if no new revenue is injected into the system, recipients could see benefit cuts of nearly one-third by the year 2039. On the other hand, if, as in the past, the solution is found primarily through payroll tax increases, the tax burden could climb fifty percent – from the current 12.4 percent of income to nearly 20 percent. Clearly, for our children and grandchildren, that alternative is unfair and unacceptable. The head of GAO, David Walker, advised members of Congress that “action taken today can ease…the pain of future actions.” In other words, he was telling Congress “do not delay.”

Taking action sooner than later was President Bush’s goal when he appointed our bipartisan commission four years ago. But, understandably, the September 11 tragedy required concerted action by the President and Congress both domestically and internationally. Accordingly, Social Security reform was taken from the frontburner and left to simmer on the backburner. This recent GAO study reminds us that in a scant few years the Social Security problem will boil over.

Central to Social Security’s financial stress is this simple fact: by the year 2030 (when the babyboom generation is fully retired) there will be only two workers for every retiree. Faced with similar circumstances, many other industrialized nations have taken steps to reform their government retirement policies. For example, in Great Britain and Australia, a pay-as-you-go Social Security system has been replaced with one that allows for workers to invest part of their payroll taxes in the stock or bond market. A basic safety net is retained, but workers in these nations now have the opportunity to create a retirement nest egg for themselves beyond the safety net.

The United States would do well to enact similar reforms. Polling data shows that most Americans support private investment accounts as part of Social Security, with overwhelming support coming from younger voters. Young Americans are already fearful that our current system is promising more than it can deliver. They understand that Social Security in its present form can not offer them the same security that it has provided for their grandparents. They are rightly concerned that they will be forced to pay more into the system, while getting less back. In fact, one poll of voters under thirty discovered that a greater number of young people believed in UFOs than in the likelihood that Social Security would be there for them. By large margins, these same young voters are strongly in favor of the option of investing a portion of their payroll taxes in a mutual fund. In short, they want some sense of control over their financial future.

Can we honor our commitment to those currently retired or soon to retire, while moving toward a system that helps workers establish personal savings accounts? Of course we can and every credible plan for reforming Social Security assures that those at or near retirement will be held harmless to any benefit changes. In particular, President Bush's bipartisan commission has suggested three alternatives that achieve this objective at less cost than maintaining the status quo. Certainly, reforming Social Security will be no free lunch. Inevitably, some benefits will need to be curtailed in order to make the Social Security system affordable over the long term. But, as the GAO report affirms, significant benefit cuts and/or tax increases will need to occur simply to shore up the current system. All the more reason to establish private accounts, designed along the lines of the Thrift Savings Plan for federal workers, so that younger workers have the opportunity to create wealth for themselves.

Why personal accounts are needed

Private sector economists and policy analysts have long advocated transforming America's insolvent, "pay-as-you-go" Social Security program into a funded system with personal accounts, where individuals could invest some of their payroll taxes in diversified market investments, protecting Social Security funds from political misuse and building assets to pass on to their families. In a recent analysis, however, another respected government agency, the non-partisan Congressional Budget Office (CBO), came as close as a government entity ever has to endorsing personal accounts as the best way to increase savings and build assets for the future.

In "Acquiring Financial Assets to Fund Future Entitlements," released on June16, 2003 the CBO examined the options available to fund Social Security in the future. The current Social Security trust fund, which holds government bonds purchased with Social Security payroll tax surpluses, was one such attempt to pre-fund future retirement benefits. But most analysts now hold it as an example of what *not* to do. The government used payroll tax surpluses to avoid making tough choices in addressing deficits in the rest of the budget. And in 15 years when the government must begin redeeming the trust fund, it will have to raise taxes or cut spending. While the trust fund *looks* like savings, it really is just created paper assets that will have no alleviating effect on Social Security's future funding problems.

As alternatives, some have proposed either to "lock-box" Social Security surpluses for the future or to invest those surpluses directly in private stocks and bonds. But would these plans work?

The CBO seems doubtful. Regarding the lock-box, the CBO says that:

"Some policymakers have suggested that in a time of budget surpluses, the government could credit the Social Security trust funds with more government bonds. When money was eventually needed to pay benefits, the government could sell the bonds. While that strategy may appear to be reasonable, the eventual sale of those bonds would have the same effect as the government's borrowing the money then."

The experience of the past several years shows that even if politicians promise to "lock-box" Social Security surpluses, events such as terrorism, war and recession can quickly cause them to change their minds.

But what about letting the government invest the Social Security trust fund in the stock market? Government investment shares the same problem as the lock-box: there is no guarantee that surpluses won't be spent elsewhere, leaving nothing to invest. But it's even worse than that. The CBO notes that:

"…even if the government could run surpluses and devise an effective means to save them, the issue of having the government own private businesses would remain. Government ownership of stocks could affect corporate decision-making, interfere with the nation's competitive market system, and impede the efficient operation of financial markets--potentially limiting economic growth."

Alan Greenspan makes the same point anytime he's asked: government ownership of American businesses has the potential to do as much harm as good, and it's best for Social Security to steer clear of this danger.

Simply put, it's very hard for government to prevent the spending of Social Security money since it's the government itself that wants to do the spending. As the CBO clearly states:

"…even if the government had surplus receipts to invest, it is doubtful that a process to protect them would be sustainable. A future Congress, confronted by war, recession, or other urgencies, could spend the invested resources or could run larger budget deficits or smaller surpluses that offset the effect of boosting saving."

Future Congresses aren't bound by the policies of preceding Congresses, so it would be easy for them to go back on any commitment to save Social Security surpluses.

If trust funds, government investment, and lock-boxes can't work, what else could? The CBO agrees with private analysts that personal accounts--where Social Security money would be held by individuals rather than the government--offers the best chance for success:

"Assets set aside to fund future obligations are most likely to be insulated by a system in which ownership and control rest with individuals. In that circumstance, each participant has property rights and legal recourse to guard against the diversion of resources… If the money did not belong to individual participants, future policymakers could find alternative uses for it--to create a new benefit, fund a new program, or perhaps cover a budget gap."

Personal accounts may not be a perfect solution to government's lack of discipline in managing Social Security money for the future. But when it comes to saving, which is crucial if Social Security is to survive the retirement of the baby boomers, the non-partisan Congressional Budget Office found that personal accounts are the best alternative available.

Why an honest debate is needed

Despite these findings, politics will still determine the shape of the Social Security debate to come. Not surprisingly, there is a partisan fight underway over the application of the word "privatization" to President Bush's efforts, and those of many members of Congress, to establish personal accounts within Social Security. Opponents of these bills charge that they would "privatize" Social Security. Proponents say they would not. The press, understandably, shakes its collective head over the silliness of it all.

I and the other members of the President's bipartisan Commission to Strengthen Social Security became more enmeshed in this symbolic battle than we would have liked. Even before the Commission had produced a single recommendation, and as several Commission members publicly stated their opposition to privatization, there was an effort by opponents of personal accounts to convince the public that we intended to "privatize" the Social Security system.

There is a reason for this phenomenon. It is called "semantic infiltration." It is based on the principle that in politics, you have won the debate when your opponent starts using your terms.

That the term "privatization" is a misnomer is beyond reasonable dispute. Members of Congress and their staffs would be shocked to discover that the retirement savings plan in which they participate, the Thrift Savings Plan, has been "privatized." Of course, it has not, and Members know this well.

With each paycheck, Members of Congress and their staffs have the opportunity to ensure that part of their salary is saved in an account for their retirement. The assets in these voluntary accounts are tracked by the federal government and published in its annual budgets.

The President's Commission believed that what is good enough for Members of Congress is good enough for the rest of America, and recommended a similar system for Social Security. The independent Office of the Social Security Actuary wrote of the accounts recommended by the Commission, " it is reasonable to combine the amounts of Trust Fund assets and personal accounts for a representation of total system assets." That doesn't sound like privatization to me.

So why the persistent use of the “P-word?” It’s because opponents of personal accounts know that it carries connotations of tearing apart the publicly administered Social Security system, something the public would never tolerate. They are placing a bet that perception will win out over reality.

The political allure of “privatization” as an attack word is so great that its adherents have taken to stretching its meaning beyond reasonable recognition. It is being twisted away from its true meaning of dismantling a publicly-administered system, and being applied to any attempt to begin saving Social Security contributions in funded accounts. This warping of language is dangerous. At a time when we sorely need to begin funding our future obligations, it demonizes efforts to do precisely that.

Words are powerful, and it is important that they not obscure the substantive realities behind them. And the reality here is that participants in Social Security will have greater expected retirement income if we establish Social Security personal accounts.

We know, for example, from the reports of the nonpartisan Social Security Actuary that participants in the system will have higher expected benefits if personal accounts are established than if they are not. A low-income couple who participated in such accounts and retiring in 2042 would expect, under Commission Reform Model 2, a monthly benefit of $1051 in inflation-adjusted dollars, compared to $806 for those who did not. Under current law, the existing system would only be able to pay that couple $655.

These projections, however, understate the full case for personal accounts, which is their role in providing participants in the system, for the first time, with a “measure of wealth.” That low-income couple would have more than $140,000 in their accounts by the time of retirement, even using conservative rate of return assumptions. The benefits of access to such owned wealth cannot be measured solely by quantifying the monthly check from the government.

Commission co-chairman Daniel P. Moynihan referred to personal accounts as the “logical completion” of Franklin Roosevelt’s original conception for Social Security, and the historical record demonstrates that they are. In President Roosevelt’s 1935 Message to Congress on Social Security, he outlined a vision for ultimately extending the program to include “voluntary contributory annuities, by which individual initiative can increase the amounts received in old age.” It is a measure of the bipartisan success of Social Security that a Republican President, George W. Bush, is now striving to make FDR’s vision a reality.

As the press contemplates how to report on the ongoing war of words, I urge them to offer less coverage to the practitioners of Social Security politics, and more to the substance of Social Security policy. This substance is not illuminated by the one-page press releases of actors on the political stage, nor their mouthpieces at allied think tanks.

The Commission published more than 250 pages of bipartisan, independent analysis of alternative approaches to Social Security, which we commend to the attention of all reporters. The better informed about the substance that the public is, the less likely that they will be influenced by the crass politics of insinuation.

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